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July 02, 2008

Pool =

State =

Organization =

Dear _____ :

This is in reply to your letter dated March 4, 2008, requesting a ruling that the income of Pool is excluded from gross income under section 115(1) of the Internal Revenue Code.

FACTS

Pool is an unincorporated association of counties and certain other governmental units in State that pools the casualty, public liability and workers compensation risks of its members. It was formed through the merger of three pre-existing risk pools. Pool intends to continue the insurance programs previously operated by the merging entities. The purpose of the merger is to enhance the financial security of the insurance programs and provide economies of scale. Pool self insures certain risks and purchases excess insurance policies when deemed appropriate.

According to its bylaws, Pool is governed by a board of eleven directors. Each director is an employee or an elected official of one of the members. Any director may be removed, with or without cause, by a majority vote of the members of Pool. A governmental entity becomes a member by entering into an interlocal agreement with Pool. Pool proposes to amend its bylaws to clarify that only an organization that is a political subdivision of a state or an entity the income of which is excluded from gross income under section 115 may become a member of Pool.

Organization is under contract with Pool to provide administrative services and serve as fund manager. Organization is a nonprofit, membership corporation established by resolution of the State legislature. Organization has previously received a ruling from the Internal Revenue Service that it is exempt from federal tax under section 501(c)(4) of the Code. Pool proposes to amend its bylaws to provide that Organization may be removed and replaced as fund manager of Pool by a 2/3s vote of the members of Pool.

Pool's income comes from contributions and fees from its members and investment income. Pool makes expenditures to cover claims payable, the cost of certain insurance premiums and the cost of administering the risk pool. Any surplus resulting from an excess of revenue over expenditures may be distributed or refunded to Pool's members. No net earnings of Pool may inure to the benefit of, or be distributed to, any private person, except as reasonable compensation for services or goods. In the event of dissolution, Pool's assets are to be distributed to its members. In no case will any remaining assets in Pool be distributed to an entity that is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under section 115 of the Code.

LAW AND ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utilities or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are

within the ambit of a sovereign to properly conduct. In addition, pursuant to section 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Pool was created to provide insurance to its members. Its members are required to be political subdivisions of a state or entities the income of which is excluded from gross income under section 115(1). Providing insurance to such governmental entities constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Pool performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Pool is used solely to provide benefits to its members and their employees. Private interests do not participate in or benefit from income of Pool, other than as provided in Rev. Rul. 90-74. In the event of the dissolution of Pool, all its remaining assets, after the payment of debts and obligations, shall be distributed to its members. The benefit to the members' employees is incidental to the public benefit. See Rev. Rul. 90-74.

Based on the information and representations submitted by Pool, and providing the proposed amendments submitted by the taxpayer are adopted, we hold that the income of Pool is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1) as of the date the proposed amendments become effective. Accordingly, Pool's income is excludable from gross income under § 115(1) of the Code.

No opinion is expressed concerning the federal tax consequences of Pool under any other provision of the Code other than those cited above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

Sincerely,

Sylvia F. Hunt
Assistant Chief, Exempt Organizations
Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:

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